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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 644

LANSING BROADCASTING COMPANY,
a Michigan corporation,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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WO. 2-8745—WO. 2-8732

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Lansing Broadcasting Company, a Michigan corporation, respectfully prays that a Writ of Certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on June 5, 1970.

(a) OPINIONS BELOW

The opinion of the Court of Appeals, not yet reported, appears in the Appendix hereto. The opinion of the Tax Court of the United States, reported in 52 T.C. 299, also appears in the Appendix hereto.

(b) JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on June 5, 1970. A timely Petition for Rehearing was denied on July 16, 1970 and this Petition for Certiorari was filed within ninety days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

(c) QUESTION PRESENTED

Whether the gain realized by Petitioner on a distribution in complete liquidation of another corporation was gain derived from a "sale or exchange" of stock under Section 1372(e)(5) of the Internal Revenue Code of 1954 with the result that Petitioner's election to be exempted from corporate income taxes was automatically terminated.

(d) STATUTORY PROVISIONS

All statutory references in this Petition are to the Internal Revenue Code of 1954, as amended, unless otherwise stated.

SECTION 1372. ELECTION BY SMALL BUSINESS CORPORATION.

* * * * * *

(e) Termination—

* * * * *

(5) Personal Holding Company Income—An election under subsection (a) made by a small business corporation shall terminate if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than 20 percent of which is derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom). Such termination shall be effective for the taxable year of the corporation in which it has gross receipts of such amount, and for all succeeding taxable years of the corporation.

* * * * *

SECTION 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATION. (a) General Rule—(1) Complete liquidations.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. (2) Partial liquidation.—Amounts distributed in partial liquidation

of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock. (b) Nonapplication of section 301.—Section 301 (relating to effects on shareholder of distributions of property) shall not apply to any distribution of property (other than a distribution referred to in paragraph (2)(B) of section 316(b)), in partial or complete liquidation.

(e-g) CONCISE STATEMENT

Petitioner has been engaged in the business of operating a commercial radio broadcasting station under the call letters "WILS" at Lansing, Michigan, since 1946.

On December 1, 1958, Petitioner elected, in accordance with the provisions of section 1372(a), not to be subject to corporate income tax for the year 1958, and met all the requirements of that section. From January 1, 1958, through December 31, 1964, this election was not terminated by formal revocation or through the addition of new shareholders who failed to consent to the election. For each of the years 1958 through 1964, Petitioner filed a Form 1120-S, U.S. Small Business Return of Income, with the District Director in Detroit, Michigan.

During 1962 Petitioner owned 53.625 percent, 21,450 shares, of the stock of Chief Pontiac Broadcasting Company (hereinafter Chief Pontiac), with a cost basis of $21,450. Pursuant to a plan of complete liquidation adopted in accordance with the provisions of section 337, Chief Pontiac sold substantially all of its assets for cash on October 15, 1962. Thereafter it distributed its cash and remaining assets to its shareholders in complete liquidation. Petitioner received cash liquidating distributions of

$187,687.50 on October 19, 1962, $32,175 on April 10, 1963, and $13,541.72 on May 28, 1963. At the time of the final liquidating distribution in 1963 Petitioner surrendered its Chief Pontiac stock, and, on May 10, 1963, Chief Pontiac filed a certificate of dissolution with the Michigan Corporation and Securities Commission.

The return filed by Petitioner for 1962 reported gross receipts and other income as follows:

Gross Receipts	$569,048.19
Interest on U. S. Obligations	5,552.59
Rent	1,689.10
Net Long Term Capital Gain	166,237.50
Other Income	8,971.04
Total Income	$751,498.42

The net long term capital gain of $166,237.50 represented the first liquidating distribution received from Chief Pontiac adjusted for the stock's cost basis of $21,450.

Paragraph (5) of section 1372(e), as it stood in 1962, provided that an election under section 1372 would be terminated if the electing corporation had gross receipts of which more than 20% was derived "from royalties, rents, dividends, interest, annuities, *and sales or exchanges of stock or securities* (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom)." (Italics added.) Petitioner's gain from the liquidation of Chief Pontiac plus its interest and rental income constituted over 20% of its gross receipts in 1962. Therefore, if such gain was derived from *the sale or exchange of stock* within the meaning of section 1372(e)(5), Petitioner's subchapter S

status terminated as of January 1, 1962 and Petitioner must pay corporate income taxes, plus interest, as follows:

Taxable Years	*Income Taxes*
1962	$129,104.09
1963	95,196.52
1964	55,449.66
Total	$279,750.27

If not, the Court of Appeals incorrectly held in favor of Respondent.

(h) REASONS FOR GRANTING THE WRIT

The issue involved is significant since its resolution transcends many sections of the Internal Revenue Code. Further it is an issue of first impression involving the provisions of subchapter S of the Internal Revenue Code, which are widely relied upon by the American business community.

The Court of Appeals had only to deal with the meaning of the words "'sales or exchanges" of stock as found in Section 1372(e)(5). Instead of limiting that phrase to transactions which are clearly and plainly sales or exchanges, the Court below disregarded the clear purpose of the statute by including within the sweep of a "sale or exchange of stock" a partial distribution in complete liquidation of a corporation. In order to attain that result, the Court had to reach outside of section 1372(e)(5), justifying its view under section 331(a)(1) which states that amounts distributed in liquidation of a corporation "shall be treated as" payment in exchange for stock.

The effect of the decision is to authorize the transplantation of a section of the Code which for certain purposes denominates a transaction as something different than its true character, into other provisions of the Code [here, section 1372(e)(5)] which were enacted for entirely different purposes. The precedent set by this decision has far-reaching implications since the term "treated as" a sale or exchange or similar terminology appears throughout the Code. In each instance the language is used to accomplish a purpose peculiar to the specific section in which it appears. For example, under section 631, in certain circumstances the mere cutting of timber is "considered as" a "sale or exchange" of timber. If the principle of the decision of the Court below is applied to section 631, then the cutting of timber will be denominated a "sale or exchange" for all purposes under the Code. This result would also follow, *inter alia,* under section 1235 which "treats" certain patent licensing agreements as the sale of a capital asset held for more than six months, and section 1244 which mitigates the financial loss suffered when small business corporations' stock becomes worthless by "treating" such losses as ordinary and not capital losses.

The question presented here is one of first impression and research has not developed any decided case which touches on the point involved.

The clear dissimilarity between "the sale or exchange" of stock and "a distribution and liquidation" is readily apparent. Patently, a sale or exchange results in each of the parties to a transaction receiving something completely different from what they previously had and also something to which they previously had no right or title. On

the other hand, a "distribution in liquidation" merely gives to the recipient shareholder that to which he was already entitled. Further, a sale of shares of stock results in the substitution of one shareholder for another but the corporation's earnings and profits nevertheless remain unchanged and intact. When such earnings and profits are distributed by an active corporation, they are taxed as dividends; but when distributed in liquidation, they are "treated as in payment in exchange for the stock" and are not taxed as a dividend. The shareholder, in the latter situation, has not sold his stock. He has merely changed the fashion in which he held title to the corporate assets.

If Congress had intended the "sale or exchange" provision of section 1372(e)(5) to embrace a distribution in liquidation, it would have said so. This Court has said:

> "Generally speaking, the language in the Revenue Act, just as in any statute, is to be given its ordinary meaning and the words 'sale' and 'exchange' are not to be read any differently . . ." (*Helvering v. William Flaccus Oak Leather Co.*, 313 U.S. 247 (1941))

Similarly, the Tax Court has stated:

> "The words 'sale' and 'exchange' as used in the Internal Revenue Code must be given their ordinary meaning . . ." (*Gaius G. Gannon v. Comm.*, 16 T.C. 1134 (1951))

Congress could have accomplished this through the use of the same language found in the personal holding company income tax regulations, in section 1.543-1(b)(5), which states, in part:

> "Gain from the sale or exchange of stock or securities . . . gross income and personal holding company income include the amount by which the

gains exceed the losses from the sale or exchange of stock or securities. . . . For this purpose, there shall be taken into account all those gains includable in gross income (*including gains from liquidating dividends and other distributions of capital*)" . . . (emphasis added).

(i-j) DOCUMENTS APPENDED

Copies of the opinions and judgments sought to be reviewed are appended hereto.

(k) RELIEF REQUESTED

The Petitioner respectfully prays that this Honorable Court grant the Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

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APPENDIX

No. 3711-67

Before
THE TAX COURT OF THE UNITED STATES

Lansing Broadcasting Company,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

OPINION

(52 T. C. 299)
(Filed May 20, 1969)

In 1962, petitioner received one of a series of distributions in complete liquidation of another corporation. *Held,* the gain realized by petitioner on the liquidating distribution is gain derived from an "exchange of stock"; therefore, more than 20 percent of petitioner's gross receipts constituted "personal holding company income," with the result that petitioner's status as a subchapter S corporation terminated in 1962.

Frank H. Boyer, for petitioner.

Chauncey W. Tuttle, Jr., for respondent.

Featherston, *Judge:* Respondent determined deficiencies in petitioner's income taxes as follows:

Year	*Amount*
1962	$129,104.09
1963	95,196.52
1964	55,449.66

The sole question is whether more than 20 percent of petitioner's gross receipts in 1962 constituted "personal holding company income" within the meaning of section 1372(e)(5)[1], with the result that petitioner's status as a "subchapter S corporation" terminated in that year. The answer depends primarily upon whether, under that section, the receipt by petitioner in 1962 of one of a series of distributions in complete liquidation of another corporation constituted "gross receipts * * * derived from * * * sales or exchanges of stock or securities * * *."

All the facts have been stipulated.

Petitioner, a corporation organized under the laws of the State of Michigan, had its principal place of business at 601 Townsend Avenue, Lansing, Michigan, at the time the petition was filed. It is engaged in the business of operating a commercial radio broadcasting station under the call letters "WILS." Petitioner filed its income tax return for 1962 on the basis of a calendar year, using the accrual method of accounting.

On December 1, 1958, petitioner elected, in accordance with the provisions of section 1372(a), not to be subject to the corporate income tax for the year 1958[2], and met all

[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise noted.

[2] Under section 1372(c)(2)(A), an election made within the 90-day period beginning on the day after the date of enactment (September 2, 1958) of subchapter S applied to the electing corporation's first taxable year beginning after December 31, 1957.

the requirements of that section. From January 1, 1958, through December 31, 1964, this election was not terminated by formal revocation or through the addition of new shareholders who failed to consent to the election. For each of the years 1958 through 1964, petitioner filed a Form 1120-S, U.S. Small Business Return of Income, with the district director in Detroit, Michigan.

During 1962 petitioner owned 53.625 percent, 21,450 shares, of the stock of Chief Pontiac Broadcasting Company (hereinafter Chief Pontiac), with a cost basis of $21,450. Pursuant to a plan of complete liquidation adopted in accordance with the provisions of section 337, Chief Pontiac sold substantially all of its assets for cash on October 15, 1962, and thereafter distributed its cash and remaining assets to its shareholders in complete liquidation. Petitioner received cash liquidating distributions of $187,687.50 on October 19, 1962, $32,175 on April 10, 1963, and $13,541.72 on May 28, 1963. At the time of the final liquidating distribution petitioner surrendered its Chief Pontiac stock, and, on May 10, 1963, Chief Pontiac filed a certificate of dissolution with the Michigan Corporation and Securities Commission.

The return filed by petitioner for 1962 reported gross receipts and other income as follows:

Gross Receipts	$569,048.19
Interest on U.S. Obligations	5,552.59
Rent	1,689.10
Net Long Term Capital Gain	166,237.50
Other Income	8,971.04
Total Income	$751,498.42

The net long term capital gain of $166,237.50 represented the liquidating distribution received from Chief Pontiac adjusted for the stock's cost basis of $21,450.

Paragraph (5) of section 1372(e), as it stood in 1962[3], provided that an election under section 1372(a) would be terminated if the electing corporation had gross receipts of which more than 20 percent was derived "from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom)." Petitioner's gain from the liquidation of Chief Pontiac plus its interest and rental income constituted over 20 percent of its gross receipts in 1962. Therefore, if such gain was derived from the sale or exchange of stock, within the meaning of section 1372(e)(5), petitioner's subchapter S status terminated as of January 1, 1962. If not, respondent erred in determining the disputed deficiencies.

To support his determination that petitioner's election terminated as of January 1, 1962, respondent relies upon

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[3] SEC. 1372. ELECTION BY SMALL BUSINESS CORPORATION.

* * * * *

(e) Termination.—

* * * * *

(5) Personal Holding Company Income.—An election under subsection (a) made by a small business corporation shall terminate if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than 20 percent of which is derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock, or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom). Such termination shall be effective for the taxable year of the corporation in which it has gross receipts of such amount, and for all succeeding taxable years of the corporation.

section 331(a)(1), which provides that "[a]mounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock." Respondent argues that this section requires that petitioner's gain from liquidation of Chief Pontiac be included, as gain derived from an exchange of stock, in making the computation of gross receipts under section 1372(e)(5). Alternatively, respondent contends that if the Chief Pontiac transaction is not an exchange, the liquidating distribution is a dividend, which is also "personal holding company income."

Petitioner urges us to interpret section 1372(e)(5) literally—without regard to section 331(a)(1)—to limit it to *pure* sales and *pure* exchanges, and thus to hold that petitioner's receipts from the liquidation of Chief Pontiac were not gains from the sale or exchange of stock. Petitioner contends that these receipts also were not dividends, since section 331(b)[4] expressly provides that section 301, relating to the effect of corporate distributions on the taxable income of shareholders, shall not apply to distributions in partial or complete liquidation of a corporation. Thus, petitioner would have us hold that the Chief Pontiac distributions were neither gains from the sale or exchange of stock nor dividends, but rather were payments in satisfaction of petitioner's right, possessed through ownership of stock, to participate in Chief Pontiac's assets remaining after corporate debts were satisfied. Cf. *C.M. Menzies, Inc.*, 34 B.T.A. 163, 168 (1936).

Quite apart from petitioner's inconsistency in contending that section 331(b), but not section 331(a)(1), should be

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[4] SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

* * * * * * *

(b) Nonapplication of Section 301.—Section 301 (relating to effects on shareholder of distributions of property) shall not apply to any distribution of property in partial or complete liquidation.

referred to in construing section 1372(e) (5), the argument that the last section's use of the phrase "sales or exchanges of stock" does not encompass corporate liquidating distributions to shareholders cannot be sustained.

Recognizing that the phrase "sales or exchanges of stock" should be construed in harmony with the legislative purpose, cf. *Helvering v. Hammel,* 311 U.S. 504 (1941), we direct our attention to subchapter S. Although section 1372(a) permits a corporation to elect "not to be subject to the taxes imposed" by chapter 1 of the Code, an electing corporation's taxable income, capital gain or loss, earnings and profits, and net operating losses must, nevertheless, be computed in order to determine the tax liability of the shareholders. Secs. 1372, 1373, 1374, 1375, and 1377. Subject to certain exceptions not material here, the taxable income of an electing corporation "is computed in the same manner that it would have been had no election been made." Secs. 1.1372-1(c)(1) and 1.1373-1(c), Income Tax Regs. Indeed, Regulations section 1.1372-1(c) provides that "[t]o the extent that other provisions of chapter 1 of the Code [which includes section 331(a)(1)] are not inconsistent with those under subchapter S of such chapter and the regulations thereunder, such provisions will apply with respect to both the electing small business corporation and its shareholders in the same manner that they would apply had no election been made." See also section 6037[5].

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[5] SEC. 6037. RETURN OF ELECTING SMALL BUSINESS CORPORATION.

Every electing small business corporation (as defined in section 1371(a)(2)) shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, the names and addresses of all persons owning stock in the corporation at any time during the taxable year, the number of shares of stock owned by each shareholder at all times during the tax-

(*Continued on next page*)

The question thus becomes whether the provisions of section 331(a)(1) are inconsistent with those of subchapter S. In our view they are not. As explained by the Committee Report accompanying the version of section 331 (a)(1) included in the Revenue Act of 1924 (S. Rept. No. 398, 68th Cong., 1st Sess. (1924), 1939-1 C.B. (Part 2) 266, 274):

> A liquidating dividend is, in effect, a sale by the stockholder of his stock to the corporation; he surrenders his interest in the corporation and receives money in place thereof. Treating such a transaction as a sale and within the capital gains provisions is consistent with the entire theory of the Act and, furthermore, is the only method of treating such distributions which can be easily administered.[6]

See also B. Bittker and J. Eustice, Federal Income Taxation of Corporations and Shareholders 338 (2d ed. 1966).

We find no provision in subchapter S that is inconsistent with this construction of section 331(a)(1). In determining the effect of the liquidation of Chief Pontiac on petitioner's taxable income, section 331(a)(1) obviously must be applied; and there is nothing in subchapter

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(*Continued from preceding page*)

able year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information, for the purpose of carrying out the provisions of subchapter S of chapter 1, as the Secretary or his delegate may by forms and regulations prescribe. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.

[6] To the same effect concerning the Revenue Act of 1918 counterpart of section 331(a)(1), see *Langstaff v. Lucas*, 9 F.2d 691, 694 (W.D. Ky. 1925), affd. per curiam 13 F.2d 1022 (C.A. 6, 1926), certiorari denied 273 U.S. 721 (1926), and *Hellmich v. Hellman*, 276 U.S. 233 (1928).

S to indicate that the gains referred to in section 1372(e)(5) are any different from the gains includible in petitioner's taxable income from Chief Pontiac's liquidation, or that the calculation thereof is to be made in any different manner. Hence, there is no alternative, particularly in view of Regulations section 1.1372-1(c) referred to above, to following the command of section 331(a)(1) that the distributions in complete liquidation of Chief Pontiac be treated as amounts received by petitioner in exchange for its stock. When this is done, petitioner's rent, interest, and gains from exchanges of stock exceed 20 percent of its gross receipts. We hold, therefore, that petitioner's subchapter S election terminated in 1962[7].

This holding coincides with the legislative purpose of section 1372(e)(5), which was to restrict the use of subchapter S to corporations having substantial amounts of operating, as opposed to investment or passive income. *Buhler Mortgage Co.*, 51 T.C. 971 (1969); *Bramlette Building Corp.*, 52 T.C. (1969); *Max Feingold*, 49 T.C. 461, 463 (1968); cf. H. Rept. No. 1238, to accompany H.R. 9883 (Pub. L. 89-389), 89th Cong., 2d Sess., p. 8 (1966); S. Rept. No. 1007, 89th Cong., 2d Sess. (1966), 1966-1 C.B. 527, 532; B. Bittker and J. Eustice, Federal Income Taxation of Corporations and Shareholders 718 (2d ed. 1966). The Committee Report accompanying the section refers to "interest, dividends, rents, royalties, or *other forms of passive income*." [Emphasis added.] S. Rept. No. 1983, 85th Cong., 2d Sess. (1958), 1958-3 C.B. 922, 1010. Chief Pontiac's operations were not shown to be related to petition-

[7] Petitioner pleads with great skill that such a holding will produce harsh results because the net gains from the liquidation of Chief Pontiac were all distributed in cash to petitioner's shareholders in each of the years 1962 and 1963. We recognize that the result is harsh. We are constrained, however, to reach our holding in the light of what in fact was done, rather than the parties' hopes and expectations as to the tax treatment of their conduct. *Temple N. Joyce*, 42 T.C. 628, 636 (1964).

er's business operations. Petitioner's gains from the liquidation of Chief Pontiac thus were obviously related to its investments rather than to the operation of its radio station WILS, and clearly fall within the broad concept of "passive investment income."

Petitioner points out that section 1.1372-4(b)(5)(x), Income Tax Regs., defining gross receipts from the sale or exchange of stock or securities, incorporates by reference the definition of "stock or securities" contained in the third sentence of Regulations section 1.543-1(b)(5)(i)[8], but

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[8] §1.543-1 Personal holding company income.

* * * * *

(b) *Definitions*—* * *

* * * * *

(5) *Gains from the sale or exchange of stock or securities.* (i) Except in the case of regular dealers in stocks or securities as provided in subdivision (ii) of this subparagraph, gross income and personal holding company income include the amount by which the gains exceed the losses from the sale or exchange of stock or securities. See section 543(b)(1) and §1.543-2 for provisions relating to this limitation. For this purpose, there shall be taken into account all those gains includible in gross income (including gains from liquidating dividends and other distributions from capital) and all those losses deductible from gross income which are considered under chapter 1 of the Code to be gains or losses from the sale or exchange of stock or securities. The term "stock or securities" as used in section 543(a)(2) and this subparagraph includes shares or certificates of stock, stock rights or warrants, or interest in any corporation (including any joint stock company, insurance company, association, or other organization classified as a corporation by the Code, certificates of interest or participation in any profit-sharing agreement, or in any oil, gas, or other mineral property, or lease, collateral trust certificates, voting trust certificates, bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, obligations), issued by or on behalf of a State, Territory, or political subdivision thereof.

does not incorporate the second sentence of that subparagraph. This latter sentence provides, in substance, that for the purposes of section 543, gains from the sale or exchange of stock and securities include liquidating distributions. The import of this omission from the regulations interpreting section 1372(e)(5), petitioner would have us hold, is that even though gain from the exchange of stock was intended to encompass liquidating dividends for the purposes of the personal holding company tax, it was not so intended for the purposes of section 1372(e)(5). Otherwise, the argument goes, the regulations interpreting section 1372(e)(5) would have incorporated the second as well as the third sentence of section 1.543-1(b)(5)(i) of the regulations.

The short answer to petitioner's contention is that such incorporation was not necessary because, as discussed above, the language of section 1372(e)(5)—"sales or exchanges of stock"—is broad enough to include liquidating distributions. The second sentence of Regulations section 1.543-1(b)(5)(i) was originally promulgated when the statute referred only to the "sale" of stock, and was retained after the statute was amended to refer to the "sale or exchange" of stock apparently because of the peculiar history of the problem. Indeed, that history confirms our conclusion.

Section 351(b)(1)(A) of the Revenue Act of 1934 defined personal holding company income to include "gains from the sale of stock," but the predecessor of Regulations section 1.543-1(b)(5)(i) interpreted the statute to apply "to all gains (including gains from liquidating dividends and other distributions from capital) from the sale or exchange of stock or securities * * *." Art. 351-2, Treas. Regs. 86. in *Helvering v. Rebsamen Motors,* 128 F.2d 584 (C.A. 8, 1942), affirming 44 B.T.A. 36 (1941),

where the issue was whether liquidating distributions were personal holding company income, the court held that the regulation went beyond the statute in construing "sale" to mean "sale or exchange" and was, therefore, invalid. Contra, *Helvering v. Syndicate Varieties,* 140 F.2d 344 (C.A. D.C., 1944), reversing a Memorandum Opinion of the Board of Tax Appeals; see *Commissioner v. Callahan Realty Corp.,* 143 F.2d 214 (C.A. 2, 1944), affirming a Memorandum Opinion of this Court. The Court's reasoning in *Robsamen Motors* was that although the phrase "sale or exchange" was broad enough to encompass a liquidating distribution, the word "sale" was not. Furthermore, section 1 of the Revenue Act of 1937, 50 Stat. 814, amended section 351(b)(1)(A) of the 1934 Act, by substituting the phrase "sale or exchange" for the word "sale"; the change was described as a clarifying amendment. H. Rept. No. 1546, 75th Cong., 1st Sess. (1937), 1939-1 C.B. (Part 2) 704, 706. The regulation remained substantially unchanged, and apparently has been retained merely to avoid any implication that the Commissioner has receded from his original interpretation of the section.

Decision will be entered for the respondent.

No. 20009

UNITED STATES COURT OF APPEALS
For The Sixth Circuit

Lansing Broadcasting Company,
Petitioner-Appellant,
v.
Commissioner of Internal Revenue,
Respondent-Appellee.

Appeal from the Decision of the Tax Court of the United States.

DECISION OF COURT OF APPEALS

Decided and Filed June 5, 1970

Before Weick, Edwards and Combs, Circuit Judges.

Weick, Circuit Judge. The sole issue in this appeal is whether the taxpayer's right to be taxed as a "small business corporation" under subchapter S of the Internal Revenue Code of 1954 (26 U.S.C. §§1371-1378) was terminated when more than 20% of its gross receipts in 1962 consisted of so-called "personal holding company income" within the meaning of section 1372(e)(5) of the Code. The Tax Court ruled against the taxpayer. 52 T.C. 299 (1969).

The facts were stipulated and were stated by the Tax Court as follows:

"Petitioner, a corporation organized under the laws of the State of Michigan, had its principal place of business at 601 Townsend Avenue, Lansing, Michigan, at the time the petition was filed. It is engaged in the business of operating a commercial radio broadcasting station under the call letters 'WILS.' Petitioner filed its income tax return for 1962 on the basis of a calendar year, using the accrual method of accounting.

"On December 1, 1958, petitioner elected, in accordance with the provisions of section 1372(a), not to be subject to the corporate income tax for the year 1958, and met all the requirements of that section. From January 1, 1958, through December 31, 1964, this election was not terminated by formal revocation or through the addition of new shareholders who failed to consent to the election. For each of the years 1958 through 1964, petitioner filed a Form 1120-S, U.S. Small Business Return of Income, with the district director in Detroit, Michigan.

"During 1962 petitioner owned 53.625 percent, 21,450 shares, of the stock of Chief Pontiac Broadcasting Company (hereinafter Chief Pontiac), with a cost basis of $21,450. Pursuant to a plan of complete liquidation adopted in accordance with the provisions of section 337, Chief Pontiac sold substantially all of its assets for cash on October 15, 1962, and thereafter distributed its cash and remaining assets to its shareholders in complete liquidation. Petitioner received cash liquidating distributions of $187,687.50 on October 19, 1962, $32,175 on April 10, 1963, and $13,541.72 on May 28, 1963. At the time of the final liquidating distribution petitioner surrendered its Chief Pontiac stock, and, on May 10, 1963, Chief Pontiac filed a certificate of dissolution with the Michigan Corporation and Securities Commission.

"The return filed by petitioner for 1962 reported gross receipts and other income as follows:

Gross Receipts	$569,048.19
Interest on U.S. Obligations	5,552.59
Rent	1,689.10
Net Long Term Capital Gain	166,237.50
Other Income	8,971.04
Total Income	$751,498.42

"The net long term capital gain of $166,237.50 represented the liquidating distribution received from Chief Pontiac adjusted for the stock's cost basis of $21,450."

It was undisputed that more than 20% of taxpayer's income for 1962 was derived from the liquidating distribution on its Chief Pontiac stock and its interest and rental receipts.

When taxpayer qualified for subchapter S benefits, it was relieved of corporate income tax, but its gains or losses were reportable pro rata by its shareholders. This operated to prevent the double taxation effect resulting from the corporate status. However, the statute contained strict limitations on this privilege, one of which limitations is contained in Section 1372(e)(5) providing for termination of subchapter S treatment if more than 20% of taxpayer's gross receipts was from "personal holding company income,"[1] *i.e.*, income "derived from royalties, rents, divi-

[1] The term "personal holding company income" was changed in 1966 to "passive investment income" in order to distinguish it from "personal holding income" as that term is used in Section 543. The amendment did not make a change in the substance of the code section. See § 1372(e)(5) as amended by Section 3(a) of Pub. Law 89-389, approved April 14, 1966. 1966 U.S. Code Cong. & Adm. News, p. 2160.

dends, interest, annuities, and sales or exchanges of stock or securities."

Taxpayer contends that the liquidating distribution which it received on its Chief Pontiac stock was not derived from a sale or exchange of such stock within the meaning of Section 1372(e)(5).

It seems to us that taxpayer is inconsistent in making such a claim because it reported the distribution on its income tax return as a long term capital gain. The only basis for capital gain treatment of the distribution is Section 331(a)(1) of the Code, which provides:

> "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock."[2]

The Treasury Regulations under subchapter S provide that the provisions of Chapter 1 of the Code, which includes Section 331(a)(1), are applicable to Subchapter S unless "inconsistent." Section 1:1372-1(c). No inconsistency has been shown.

Section 331(a)(1) of the Code and Section 1372(e)(5) are therefore in pari materia and should be construed together.

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[2] The Senate Finance Report accompanying the Act states:

> "A liquidating dividend is, in fact, a sale by the stockholder of his stock to the corporation; he surrenders his interest in the corporation and receives money in place thereof. Treating such a transaction as a sale and within the capital gains provisions is consistent with the entire theory of the Act and, furthermore, is the only method of treating such distributions which can be easily administered." (S.Rep. No. 398, 68th Cong., 1st Sess., p. 11 (1939-1 Cum.Bull. (Part 2) 266, 274.))

If the distribution is not to be treated as a sale or exchange, then it would have to be taxed as a dividend. The result would be the same.

In our opinion, the decision of the Tax Court is correct and it is affirmed.

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 644

LANSING BROADCASTING COMPANY, A MICHIGAN CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. 11–21) is reported at 52 T.C. 299. The opinion of the court of appeals (Pet. App. 22–26) is not yet reported.

JURISDICTION

The court of appeals entered an opinion and judgment on June 5, 1970. A petition for rehearing was denied on July 16, 1970. The petition for a writ of certiorari was filed on September 3, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

404-947—70

QUESTION PRESENTED

Whether the phrase "sales or exchanges of stock" in Section 1372(e)(5) of the Internal Revenue Code of 1954 includes liquidation distributions received by petitioner with respect to its stock in another corporation.

STATUTES INVOLVED

Internal Revenue Code of 1954 (26 C.F.R.):

> SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.
>
> (a) *General Rule.*—
>
> (1) *Complete liquidations.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.
>
> * * *
>
> (b) *Nonapplication of Section 301.*—Section 301 (relating to effects on shareholder of distributions of property) shall not apply to any distribution of property in partial or complete liquidation.
>
> * * *
>
> SEC. 1372 [as added by Sec. 64(a), Technical Stat. 1606]. ELECTION BY SMALL BUSINESS CORPORATION.
>
> * * *
>
> (e) *Termination.*—
>
> * * *

(5) *Personal holding company income.*—An election under subsection (a) made by a small business corporation shall terminate if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than 20 percent of which is derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom). Such termination shall be effective for the taxable year of the corporation in which it has gross receipts of such amount, and for all succeeding taxable years of the corporation.

* * * *

STATEMENT

Petitioner is a Michigan broadcasting corporation which, since 1948, has operated in Lansing, Michigan, under the call letters "WILS." On December 1, 1958, petitioner elected under Section 1372(a) of the Internal Revenue Code to be taxed as a partnership and met all the requirements of that statute. From January 1, 1958, through December 31, 1964, the election was not terminated by any corporate revocation or through the addition of any new shareholders who failed to consent to such election. (Pet. App. 23.)

In 1962, petitioner owned 21,450 shares of common stock of Chief Pontiac Broadcasting Company (Chief Pontiac), 53.625 percent of the issued and outstanding stock of that corporation. Pursuant to a plan of complete liquidation under Section 337 of the Code,

Chief Pontiac, on October 15, 1962, sold substantially all of its assets for cash. Thereafter, in 1962 and 1963, it made distributions to its shareholders in complete liquidation. (Pet. App. 23.)

On the date of the final distribution, May 28, 1963, petitioner surrendered its stock certificate to Chief Pontiac for cancellation (Pet. App. 23). On its 1962 federal income tax return, petitioner reported its income as follows (Pet. App. 24):

Gross receipts	$569,048.19
Interest on U.S. obligations	5,552.59
Rent	1,689.10
Net long term capital gain	166,237.50
Other income	8,971.04
	$751,498.42

Petitioner's net long-term capital gain of $166,237.50 resulted from the 1962 liquidation distribution it received from Chief Pontiac after subtraction of its cost basis of $21,450 (Pet. App. 24).

Section 1372(e)(5) of the Internal Revenue Code provided that a corporation's election under Subchapter S of the Code shall terminate if in any year the corporation received more than 20 percent of its gross receipts from "Personal holding company income," which included receipts from "sales or exchanges of stock" and "dividends." Twenty percent of petitioner's gross receipts in 1962 totaled $150,299.68. The Commissioner determined that the liquidating distribution petitioner received from Chief Pontiac in 1962 ($166,237.50), together with its income from rent

and interest on U.S. obligations ($7,241.69), constituted "personal holding company income" totaling more than 20 percent of its gross receipts for that year, and that, accordingly, its election under Subchapter S terminated as of January 1, 1962. (R. 14a–15a.)[1]

The Tax Court upheld the Commissioner's determination, reasoning that the liquidating distributions to petitioner in return for petitioner's Chief Pontiac stock constituted receipts derived from "sales or exchanges of stock" within the meaning of Section 1372 (e)(5) (Pet. App. 14–21). The court of appeals affirmed, holding that the liquidating distributions constituted exchanges for stock, or in the alternative, dividends, either of which would require automatic termination of petitioner's Subchapter S status under Section 1372(e)(5).

ARGUMENT

The decision below is correct. There is no conflict or any other basis for further review by this Court. Indeed, as petitioner concedes (Pet. 6, 7), this is a case of first impression.

1. Subchapter S of the Internal Revenue Code of 1954 (Sections 1371–1378) allows a closely held corporation to forego the payment of any corporate income tax and requires its shareholders to report the corporate income (whether or not distributed) as their own for tax purposes. Congress' intent was to allow businesses to select a legal form without regard to tax consequences, to assist small business corpora-

[1] "R." references are to the record appendix filed in the court of appeals.

tions where the shareholders were in a lower tax bracket than the corporation, and to allow corporate losses to be offset against the shareholders' individual income from other sources. S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 87–88. Congress qualified these benefits, however, by providing in Section 1372(e)(5), *supra*, pp. 2–3, that Subchapter S treatment shall terminate if the corporation received in any taxable year more than 20 percent of its gross receipts from "Personal holding company income,"[2] defined as "gross receipts * * * from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities * * *."

The legislative history of Section 1372 reflects the Congressional intent to limit the availability of Subchapter S to companies "actively engaged in trades or businesses" and to disqualify corporations which received a substantial amount (more than 20 percent) of their gross receipts from investment or passive income sources. S. Rep. No. 1007, 89th Cong., 2d Sess., p. 8; H. Rep. No. 1238, 89th Cong., 2d Sess., p. 8. The committee report accompanying the original legis-

[2] The term "personal holding company income" was changed to "passive investment income" in 1966, apparently to distinguish it from "personal holding company income" as that term is used in Section 543, Act of April 14, 1966, P.L. 89–389, 80 Stat. 111, Sec. 3(a). The committee reports accompanying the 1966 legislation indicate that the amendment was only a matter of phraseology and not a change of substance, stating that the new term "contain[s] the same general rule as existing law" and that "passive investment income" means "the same gross receipts as are taken into account under existing law." S. Rep. No. 1007, 89th Cong., 2d Sess., p. 20.

lation states that interest, dividends, rents, royalties, "*or other forms of passive income*" must be limited. (Emphasis added.) S. Rep. No. 1983, *supra*, p. 89. That petitioner's gains from the liquidation of Chief Pontiac come within the passive investment type limitation is fully supported by the Tax Court's uncontested finding (Pet. App. 18–19) that petitioner held its Chief Pontiac stock as an investment rather than as part of its business operations.

2. Petitioner's contention that the courts below erred in looking to Code Section 331(a)(1), *supra*, p. 2, to determine that the liquidation distributions in issue should be "treated as * * * in exchange for the stock" is without merit. First, Sections 1.1372–1(c)(1) and 1.1373–1(c) of the Treasury Regulations on Income Tax (1954 Code) provide that a Subchapter S corporation must apply the provisions of Chapter 1 of the Code (which includes Section 331) in computing its income. Section 331(a) is the correct—indeed the only—statute which sets forth how a liquidating distribution is to be treated in computing a shareholder-corporation's taxable income. This computation must be performed and an annual return submitted even though there is no tax on the Subchapter S corporation's income. See Section 6037; see also Sections 1373–1378. While petitioner condemns this "reaching outside" of Section 1372 to characterize the liquidating distribution, it does not challenge the validity of the Treasury Regulations, nor does it suggest an alternative method or authority

for determining the nature of the liquidating distributions to it.[3]

Second, petitioner itself reported (R. 6a, 14a) the gains from the liquidating distributions as capital gains, obviously relying on Section 331(b), since Sections 301(a) and 316 would otherwise require that such amounts be treated as dividends. It would be illogical to allow petitioner on one hand to rely on Section 331(b) to report the gains from the liquidating distributions as capital gains, and on the other to ignore the denomination in Section 331(a) of such distributions as payments "in exchange for the stock."

Third, the legislative history of Section 331 reveals that the "ordinary meaning" of a liquidating distribution is that of a "sale by the stockholder of his stock to the corporation" in return for money. S. Rep. No. 398, 68th Cong., 1st Sess., pp. 11–12.[4] Petitioner's con-

[3] The fact that Section 1.543–1(b)(5) of the Regulations, interpreting the phrase "Gains from the sale or exchange of stock" in 1954 Code Section 543(b)(2), states that this phrase "include[s] gains from liquidating dividends" is not relevant here. This inclusion was placed in Article 351–2 of Treasury Regulations 94 for clarification when the predecessor of Section 543, Section 351(b) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, read only "gains from the sale of stock." The reference to "liquidating distributions" in the Regulations was retained after the words "or exchanges were added to the statute by Section 1 of the Revenue Act of 1937, c. 815, 50 Stat. 813. See generally 7 Mertens, *Law of Federal Income Taxation* (Rev. ed.), Sec. 40.07. Section 543(b)(2) was repealed for taxable years after December 31, 1963, by Section 225 of the Revenue Act of 1964, P.L. 88–272, 78 Stat. 19.

[4] Contrary to petitoner's argument (Pet. 7), there is no danger that application of the words "treated as a sale or exchange" or the like in other revenue statutes, in conjunction with Section 1372(e)(5), will lead to distortion of the latter

trary claim (Pet. 7–8) is without supporting authority and contradicts the Congressional conclusion that liquidating distributions constitute exchanges of stock for corporate assets.

3. As the court of appeals alternatively held (Pet. App. 26), if the liquidating distributions were not treated as exchanges for stock under Section 331, then they would have to be dividends under Sections 301(a) and 316. This rationale, to which petitioner has not addressed itself in this Court, would also require termination under Section 1372(e)(5) of petitioner's Subchapter S election for the taxable years in issue.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1970.

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statute. Turning to petitioner's examples, treatment of timber cutting as a sale or exchange pursuant to Section 631(a) is by election only; it is thus easily avoided by a Subchapter S corporation. Section 1244 applies only to individuals, not corporations. See Section 1.1244(a)-1(b) of the Treasury Regulations. Section 1235 describes the tax treatment of the transfer of all substantial rights to a patent. Such transactions involve essentially investment type income, the substantial receipt of which Section 1372(e)(5) was designed to prevent.

U.S. GOVERNMENT PRINTING OFFICE: 1970